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Market Update: Too Hot to Handle

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Inflation Issues

After a historically strong first quarter, we have had some weakness in the stock market to start off Q2. While most of us had our eyes on the eclipse, investors were blinded with an update on inflation. Unfortunately, a hotter-than-expected inflation print "eclipsed" the optimism around Federal Reserve (Fed) interest rate cuts and created more uncertainty for the markets.

Summary of results for the reported Consumer Price Index (CPI) from the U.S. Bureau of Labor Statistics:

1. **CPI**, a measure of consumer prices, increased by 3.5% for March (year-over-year), up from the previous month's 3.2% and above consensus estimates of 3.4%. This is the highest reading since last September and was primarily driven by large increases in medical costs, insurance premiums, and oil prices.
2. **Core CPI**, which strips out the more volatile food and energy prices, held steady with 3.8%, although also above estimates.

The good news – Core inflation, which is the preferred metric for the Fed to monitor, continues to stand steady at nearly a three-year low and there is potential for it to continue to come down toward the Fed's key target inflation rate of 2%.

The bad news – Probabilities of interest rate cuts starting in June and July dropped significantly. Current market expectations indicate cuts could start in September, with potentially fewer cuts for 2024.

The bottom line remains the same, the next move for the Fed is a cut, but we may have to wait a while longer. And the prospects of lower interest rates this year will continue to be a tail wind for investment markets.

Perception Versus Reality for Investment Returns

When the market takes a tumble, it's natural to feel some internal pain, after all loss hurts. There is some science behind it. Prospect theory is a concept in behavioral economics based on a study done by Daniel Kahneman and Amos Trevsky, for which Kahneman won a Nobel prize in 2002 as the pioneer of integrating psychology into economics.

I sum up his findings with a simple drawing:

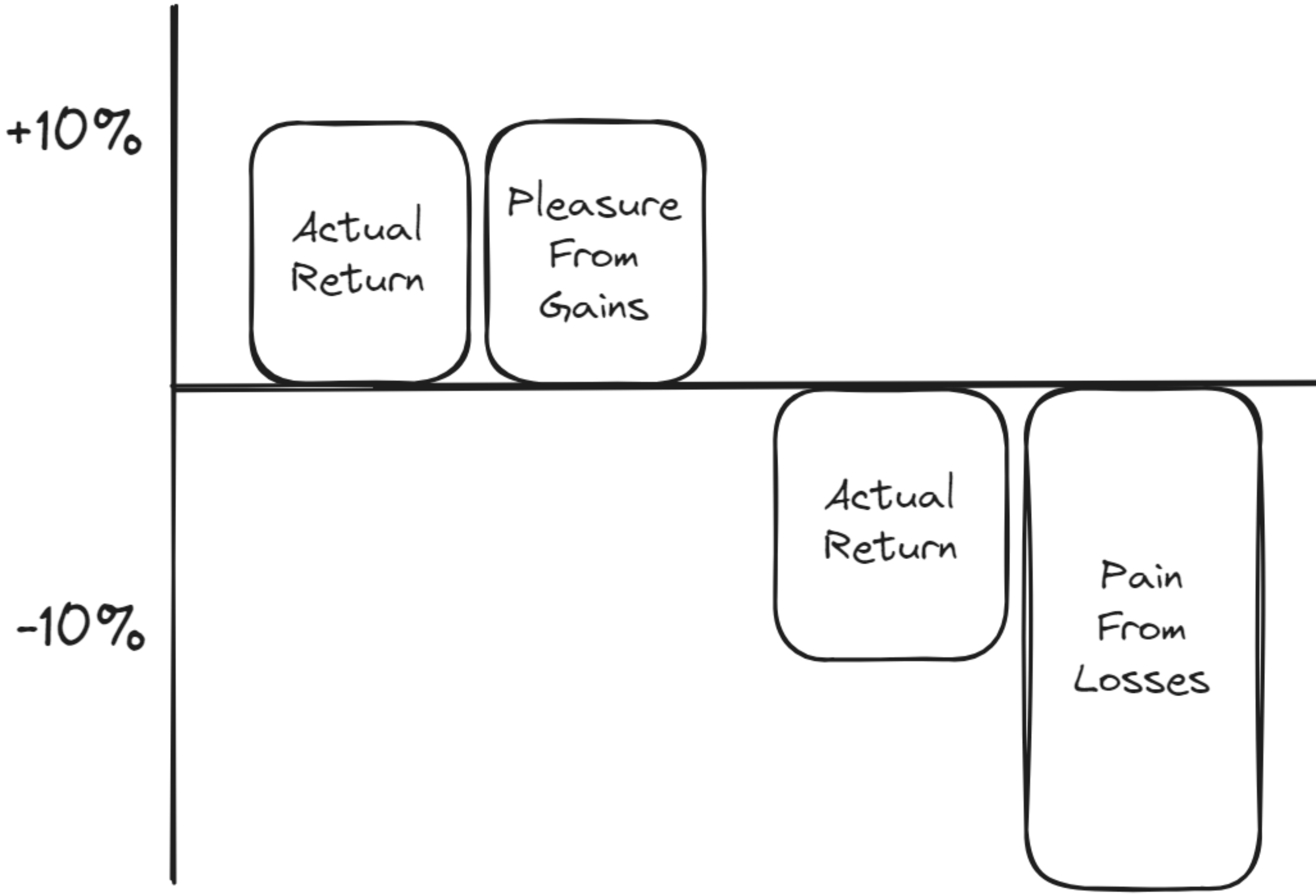
1. **Loss Aversion** – Humans feel the emotional impact of loss much more than gains. In fact, it is estimated that the impact of losses is double that of equivalent gains.

2. **Investment Implications** – While history would suggest that stocks provide the highest returns over the long-term, and saving for retirement is a long-term game, loss aversion is powerful enough to impact decision making for most investors. This is why many continue to hold significant allocations in bank accounts, which yield almost nothing, but give us peace of mind that the money will not be lost.

3. **Controlling Emotions** – It is healthy to understand and manage risks as best as possible to avoid detrimental losses. However, the biggest risk is not having enough savings in retirement. By understanding our behavioral tendencies and the concept of loss aversion, we can be more conscious of short-term losses and focus more on long-term gains.

Stay diversified my friends.

What Gaining and Losing 10% in the Market Feels Like



Source: Kostya Etus

As always, Dynamic recommends staying balanced, diversified and invested. Despite short-term market pullbacks, it's more important than ever to focus on the long-term, improving the chances for investors to reach their goals.

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